LIBRARY
SUPREME COURT, U. S.

FILED
MAR 1 1974
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1166

WILLIAM E. HUTTON; JOSEPH A. W. IGLEHART; JAMES J. LEE; WILLIAM C. MILLER; EARL K. BASSETT; JOHN M. BLEAKIE; ERNEST E. KEUSCH; BENJAMIN D. WILLIAMS; JOHN J. ANGLIM; REGINALD N. BARNARD; JUSTIN J. STEVENSON, JR.; J. LOGAN BURKE; JAMES M. HUTTON, III; THOMAS C. CAFONE; HART HAGIN; CLINTON J. COOMBS; ARTHUR T. HAMILL; JAMES M. HUTTON, III, EXECUTOR OF THE ESTATE OF DEFENDANT JAMES M. HUTTON, JR., DECEASED; ROBYN B. HALL, VERNON H. HALL, III and DUDLEY HALL, EXECUTORS OF THE ESTATE OF DEFENDANT VERNON H. HALL, II, DECEASED; and W. E. HUTTON & CO., A PARTNERSHIP,

Petitioners,

v.

THE JOHNS HOPKINS UNIVERSITY,

Respondent.

BRIEF OF RESPONDENT THE JOHNS HOPKINS UNIVERSITY (HOPKINS), IN OPPOSITION

JOHN HENRY LEWIN,

EDMUND P. DANDRIDGE, JR.,
1800 Mercantile Bank & Trust Bldg.,
Two Hopkins Plaza,
Baltimore, Maryland 21201,

Attorneys for Respondent.

The Daily Record Co., Baltimore, Md. 21203

Table of Contents

	PAGE
Questions Presented	2
Statement of the Case	9
The Facts	12
Argument	21
I. There is No Conflict Between the Present Decision and the Decisions or *Dicta* of the Eighth, Fifth and Second Circuits	22
II. Hopkins Would Have Been Entitled to Recover Under the *Mills* and *Ute* Decisions If It Had Not Proved Actual Reliance On the "Defects" (Material Misstatements and Omissions) in Huttons' Sale Solicitations	28
Conclusion	34

Table of Citations

Cases

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972)	7, 8, 22, 28, 31, 32, 33
Baumel v. Rosen, 283 F. Supp. 128 (D. Md. 1968); affd in part, rev'd in part, 412 F.2d 571 (4th Cir. 1969); cert. den. 396 U.S. 1037 (1970)	29, 30
Bishop v. E. A. Strout Realty Agency, Inc., 182 F.2d 503 (4th Cir. 1950)	27
J. I. Case v. Borak, 377 U.S. 426 (1964)	33
Chasins v. Smith, Barney & Co., Inc., 438 F.2d 1167 (2d Cir. 1971)	32, 33
City National Bank v. Vanderboom, 422 F.2d 221 (8th Cir. 1970), reh. den. 3/20/70	22, 23
Dale v. Rosenfeld, 229 F.2d 855 (2d Cir. 1956)	27
Clement A. Evans & Co., Inc. v. McAlpine, 434 F.2d 100 (5th Cir. 1970)	22, 25

PAGE

Federal Trade Commission v. Standard Education Society, 302 U.S. 112 (1937) 27
Heit v. Weitzen, 402 F.2d 909 (2d Cir. 1968) 24fn
The Johns Hopkins University v. Hutton, et al., 297 F. Supp. 1165 (D. Md. 1968) 4, 30, 34
The Johns Hopkins University v. Hutton, et al., 422 F.2d 1124 (4th Cir. 1970) 4, 6, 9, 10, 28, 29
The Johns Hopkins University v. Hutton, et al., 326 F. Supp. 250 (D. Md. 1971) 4, 7, 9, 11, 29
The Johns Hopkins University v. Hutton, et al., 488 F.2d 912 (4th Cir. 1973) 4, 6, 7, 9, 10, 11, 22, 28, 29
Kohner v. Wechsler, 477 F.2d 666 (2d Cir. 1973) 22, 26
List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir. 1965) 7, 29, 30, 32
Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970) 7, 8, 22, 28, 31, 32
SEC Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) 27, 33
SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) 24fn
Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) 33

Statutes and Regulations

Securities Act of 1933:
§12(2) (15 U.S.C. §771(2)) 6, 29
§17(a) (15 U.S.C. §77q(a)) 5, 6, 7, 21, 29
Securities Exchange Act of 1934:
§10b (15 U.S.C. §78j(b)) 5, 6, 7, 9, 10, 21, 23, 24, 26, 28, 29, 32

Other Authorities

A.L.I. Restatement of Torts
Section 538 (1) and (3) 28
Section 540 28
Section 541 28

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1166

WILLIAM E. HUTTON; JOSEPH A. W. IGLEHART; JAMES J. LEE; WILLIAM C. MILLER; EARL K. BASSETT; JOHN M. BLEAKIE; ERNEST E. KEUSCH; BENJAMIN D. WILLIAMS; JOHN J. ANGLIM; REGINALD N. BARNARD; JUSTIN J. STEVENSON, JR.; J. LOGAN BURKE; JAMES M. HUTTON, III; THOMAS C. CAFONE; HART HAGIN; CLINTON J. COOMBS; ARTHUR T. HAMILL; JAMES M. HUTTON, III, EXECUTOR OF THE ESTATE OF DEFENDANT JAMES M. HUTTON, JR., DECEASED; ROBYN B. HALL, VERNON H. HALL, III and DUDLEY HALL, EXECUTORS OF THE ESTATE OF DEFENDANT VERNON H. HALL, II, DECEASED; and W. E. HUTTON & CO., A PARTNERSHIP,

Petitioners,

v.

THE JOHNS HOPKINS UNIVERSITY,

Respondent.

BRIEF OF RESPONDENT THE JOHNS HOPKINS UNIVERSITY (HOPKINS), IN OPPOSITION

Respondent Hopkins is not dissatisfied with the presentations in the Petition of Hutton under the headings Opinions Below, Jurisdiction and Statutes Involved.

QUESTIONS PRESENTED

Hopkins is *completely dissatisfied* with Huttons' *Questions Presented*, believing that they are falsely premised upon misstatements of facts and serious misinterpretations by Hutton of the decision of the Court of Appeals. For example, with regard to Huttons' Questions Presented Nos. 1 and 4 (which seem to be the same in substance), there are no less than the following seven false premises:

1. While the members of Hopkins' Finance Committee were knowledgeable in general finance and ordinary investments, they had never before purchased, and were totally inexperienced in, oil and gas production payments and oil and gas reserves. Hopkins was not at all a knowledgeable investor in such securities. On the other hand, Hutton, the brokers who solicited and pressed Hopkins over a period of five months to buy the security in question, maintained an Oil and Gas Department, had dealt for years extensively in oil and gas drilling participation securities and particularly in those created by the Trice Production Company (Trice), with which they had had many years of close intimate business association and which they were in the process of refinancing by the sale of its production payments at the time of Hopkins' purchase.

2. Hopkins had the assistance of its regular investment counselor, Naess. But Naess' recommendation of the purchase was not based on any independent investigation which he made of the estimates of the oil and gas reserves, He was not called upon to make, and did not make, any such investigation. He never saw the true estimates. His recommendation was based upon the same material misrepresentations and concealments of Hutton by which Hopkins was induced to make the investment.

3. While Hopkins had the assistance of legal counsel in passing only upon the drafting and form of the security, *after* and not before its Finance Committee had voted to make the purchase, it did not have any recommendation from them to make the investment, and did not do so, or decide to do so, upon any advice from the lawyers whatsoever.

4. Hopkins had long had a high regard for Hutton's ability and integrity (some members of its Finance Committee being friends of Hutton partners). The Manager of Huttons' Oil and Gas Department initiated the transaction and Hopkins thereafter had "face-to-face negotiations" over a period of five months, not with the "seller" Trice (contacts with whom were minimal, Hopkins having had only *one* meeting with Trice — and that in the presence of Hutton — before Hopkins decided to make the purchase), but with the selling broker Hutton, who, repeatedly during that time, importuned Hopkins orally and in writing to make the purchase, made the sale, and earned a commission for doing so.

5. After Hopkins' decision to buy but shortly before the purchase was consummated, one misstatement only among those which Hutton had made to Hopkins, (concerned merely with the number and identity of the independent engineers who had estimated the oil and gas reserves of all the wells) was corrected. Instead of those engineers being DeGolyer and MacNaughton (D&M) and Schafer only, as Hutton had first told Hopkins, Hopkins was informed that petroleum engineers of the Mercantile National Bank, Dallas, Texas, had made the estimates on five of the 23 wells. Joined with the corrected information, however, was a confirmation *to the dollar* of Huttons' other far more material misrepresentations as to the amount of the estimates, upon which uncorrected falsehoods the lower Courts found Hutton guilty of actionable fraud. This partially correcting information

further supported these more material misrepresentations and left them in force and unsuspected.

6. Far from having "such knowledge, information and notice as would have led a reasonable investor to discover" Huttons' fraud, Hopkins (as the District Court found and the Court of Appeals affirmed (App. B. 13, F. 4, E. 11)) had not even a suspicion of it; and this lack of suspicion was held to be objectively reasonable (App. B. 13, App. A. 4). Almost a full year after making this purchase, Hopkins was so happy with it that it decided to buy, and did buy, a second Trice oil and gas production payment. The Court of Appeals ruled on the first appeal that in 1962, long after Hopkins made the purchase and had "worries" with its investment and made investigations regarding them, it still did not suspect fraud or even inadequacy of the reserves (App. E. 11).

7. Hopkins, as the lower Courts have held (App. B. 13, App. A. 4), had no "ready access to all the pertinent facts" prior to the purchase. The most pertinent facts were contained in the estimates of the independent engineers, which true estimates Hutton possessed, misrepresented, and failed to furnish, although requested by Hopkins to do so. This is one of the very material omissions of Hutton for which Hutton was held liable (App. F. 111, App. E. 6). These true facts were also in the possession of Trice in Texas. By the "terms of the production payment", Hopkins, *after but not before the purchase*, had the contract right to inspect these reports (App. E. 11). The quotation which Hutton makes from the first opinion of the Court of Appeals (as holding "(b)" in their Question Presented No. 4, repeated later on pages 5, 7, 8, 11 and 22 of the Petition) shows on its face that it does not refer to any supposed right of Hopkins "prior to purchase". Hutton is simply distorting the meaning of the quotation by repeatedly inserting in it the phrase "prior to purchase". Furthermore, Hutton had also mis-

represented to Hopkins, and Hopkins believed, that another petroleum engineer, Brown, had acted for Hopkins instead of for Hutton and Trice, and had inspected and checked these earlier engineers' reports on Hopkins' behalf. To have uncovered Huttons' fraud prior to purchase would have called for an affirmative investigation of Trice's documents in Texas, which unsuspecting Hopkins did not undertake.

To correct the foregoing false factual premises, Huttons' Question Presented Nos. 1 and 4 should be revised to read as follows:

> 1. and 4. Should Hopkins, generally knowledgeable but completely inexperienced in oil and gas reserve securities, who, after being repeatedly solicited to do so in face-to-face negotiations for five months by Hutton, brokers in whom Hopkins had complete confidence and who were highly experienced in such securities (from long and extensive dealings with them and long close association with their issuer Trice), purchased such a security from Hutton, be precluded from recovery from Hutton under §§ 10(b) and 17(a) of the federal securities Acts, for injury proximately caused by material misstatements and concealment made with *scienter* by Hutton to Hopkins and its investment counselor, the falsity of which was unknown to and unsuspected by Hopkins or its investment counselor and upon which Hopkins relied, because (a) Hopkins' investment counsel also recommended the purchase on the basis of Huttons' misrepresentations; (b) one original misstatement of Hutton was corrected prior to the purchase, the others at the same time being confirmed; and (c) unsuspecting Hopkins did not conduct an affirmative investigation to determine whether Huttons' misrepresentations were true or false?

Huttons' Questions Nos. 2 and 3 are based upon the false premise that *actual reliance* by Hopkins upon Huttons' misstatements and concealments was not expressly found as a fact by the District Court and affirmed on appeal, a serious misinterpretation of the Court of Appeals' opinion. The first decision of the Court of Appeals in February 1970 (422 F.2d. 1124) (4th Cir., 1970) (App. E. 1 to E. 13) affirmed the District Court's Summary Judgment that Huttons' fraudulent conduct violated Section 12(2) of the Securities Act, because it, factually and beyond dispute, fulfilled every required legal element of that statute, *i.e.*, the falsity of Huttons' representations and omissions concerning a security, their materiality, Hopkins' lack of knowledge of their falsity, and that they proximately caused Hopkins' purchase and injury. The decision of the Court of Appeals on December 4, 1973 (App. A. 2 to A. 11), which Hutton now seeks to have reviewed, affirmed the District Court's later Summary Judgment that Huttons' fraud likewise made them liable to Hopkins for violations of Section 10(b) of the Exchange Act and Section 17(a) of the Securities Act, the District Court finding on the undisputed facts that the additional elements of *scienter* by Hutton of their fraud and Hopkins' *actual subjective reasonable reliance*, not only on Hutton and its sales solicitations, but also on Huttons' misstatements and concealments, were also *factually* established.

Since the District Court, affirmed by the Court of Appeals, found factually, not merely materiality and causation, but Hopkins' actual subjective and justified reliance (not merely "presumed reliance") upon the misstatements and omissions, Huttons' Questions Presented Nos. 2 and 3 are academic propositions *as far as this case is concerned.* Both lower Courts assumed that Hopkins was required to establish its actual reliance by proof which "satisfied the accepted criteria of reliance which were delineated in *List v. Fashion*

Park, Inc., 340 F.2d 457 (2d Cir., 1965)" (App. A. 4, B. 12, 18, 19). In *List* these "criteria of reliance" were held to be something more than objective materiality and required proof of *importance of the misrepresentations to the defrauded person subjectively*. The Court of Appeals affirmed the District Court's factual determination that Hopkins had established its actual reliance by such proof. Both Courts expressly recognized that this Court's decisions in *Mills v. Electric Auto-Light*, 396 U.S. 375 (1970), and *Affiliated Ute Citizens v. U. S.*, 406 U.S. 128 (1972), may have dispensed with the necessity of such proof in actions like the present one (in which reliance on Huttons' sales solicitations and proximate causation had already been found), but expressly declined to rest their decision here upon that legal ground. Because of the established fact of Hopkins' actual reliance on Huttons' fraud, it was unnecessary to do so. The Court of Appeals spoke of the *essentiality* of Huttons' misrepresentations "to Hopkins", and said, "We think the *undisputed facts* support the District Court's summary finding of liability upon Counts II, III and V" (the Courts charging violation of Sections 10(b) and 17(a).[1] Hutton are in complete error in stating (Petition p. 7): "The Fourth Circuit's unwarranted interpretation and extension of *Mills* and *Ute* is in conflict with decisions of several other Courts of Appeals". The Fourth Circuit made no interpretation or extension of *Mills* or *Ute*. Hutton are also in error in stating on the first page of their Petition: "At issue are important and unresolved questions of federal securities law arising from conflicting interpretations of the decisions of this Court" in the *Mills* and *Ute* cases. Such questions are not "at issue" in this case, and this case is not the proper vehicle for their resolution.

[1] Throughout this Brief emphasis has been supplied, even in quotations.

Since Huttons' Questions Presented Nos. 2 and 3 are purely academic, if the lower Courts were correct as to the fact of Hopkins' reliance, they cannot be corrected by rephrasing. They should be disregarded in their entirety. Only if this Court should undertake to reexamine the detailed evidence and conclude therefrom that both lower Courts committed error in this factual finding of Hopkins' reliance on the misstatements and omissions, would any questions be properly presented as to whether (causation being clearly established) the finding of such reliance, because of *Mills* and *Ute*, is legally unnecessary.

A possible Question to be substituted for Huttons' Questions Nos. 2 and 3 might then be:

> 2. and 3. Did the Court of Appeals commit clear error in approving the District Court's factual finding of Hopkins' actual reliance on Huttons' misrepresentations and concealments, and if so, was not such error harmless, because, as held in *Mills* and *Ute*, proof of actual reliance upon misstatements and omissions in such a case as this (in which Huttons' solicitations constituted "an essential link in the accomplishment of the transaction" and in which causation of injury has been properly found) is not legally necessary?

Huttons' Question Presented No. 5 also improperly invites this Court to examine great parts of the record to determine whether the District Court was in error in finding established beyond genuine dispute (and whether two separate panels of the Fourth Circuit were in error in reviewing and affirming such findings) a number of factors supporting the Summary Judgments of liability. This Question on its face is an unreasonable one, lying outside the usual review which we understand this Court will undertake on *certiorari*. The answer to such a Question would have

no importance whatever outside the interests of the particular litigants here. It is significant that Huttons' Argument is confined to attempted support for their Questions Presented Nos. 1 through 4. No argument is advanced by them in support of their Question No. 5.

It is significant also that, by none of their Questions or Arguments thereon, do Hutton challenge the lower Court's finding undisputed (a) Huttons' making of the representations and omissions, (b) *falsity*, (c) *scienter*, (d) *materiality*, and (e) *causation*. Hutton did not even appeal to the Fourth Circuit the District Court's finding of *scienter* (App. B. 11).

STATEMENT OF THE CASE

Some of the more serious of Hopkins' objections to Huttons' description of the nature of the case and the decisions below have been pointed out in our discussion of the Questions Presented. Some require mention here.

Huttons' statement (Petition p. 7) that the panel of the Court of Appeals which heard the second appeal disregarded two rulings of a different panel of the Court on the first appeal is completely without basis. The first panel held that, although Hopkins received from Trice information that "revealed LaPiere's misstatements about the identity of the estimators . . . The undisputed evidence shows that neither Hopkins, nor its advisers, learned from this report, or from any other source, the complete truth essential for prudent evaluation of the wells" (App. E. 8). In its second opinion, the Court of Appeals refers to its previous findings of "undisputed evidence of LaPiere's misrepresentations and omissions" and that they "tainted" the information which was "essential *to Hopkins' decision to purchase*", in affirming the District Court's determination of liability under Section 10(b) of the Securities Exchange Act (App. A. 4).

The first panel also concluded that certain information which Hopkins received *for the first time during 1962*, long after the purchase was made, and which, the Court found, then prompted investigations by Hopkins which "led them to believe that Trice's troubles, and Hopkins' own worries,[2] were caused by factors other than deficiencies in the estimates of the future net revenue," might, however, have led "a reasonable diligent investor to probe the data upon which he based his purchase", and that, had Hopkins then demanded the experts' estimates, which it had a contract right to do under the terms of the production payment after its purchase on March 1, 1961, it might have discovered LaPiere's earlier misrepresentations and omissions (App. E. 11). This ruling also was followed by the second panel, and the specific application of this latter ruling by the second panel to deny to Hopkins the particular remedy of rescission under Section 10(b) is the subject of Hopkins' Cross-Petition for *certiorari*.

Huttons' contentions with respect to lack of proof of Hopkins' "right to rely" and actual "reliance" are likewise without basis. The District Court, with respect to the first, stated:

> "Even if that 'right to rely' requirement exists in this case, there is nothing in the record to indicate that LaPiere, or anyone else, did or said anything which would have led *Hopkins, as a reasonable man*, to suspect that material information was being misrepresented to or withheld from Hopkins. LaPiere's misrepresentations

[2] These 1962 "troubles" of Trice, who from the beginning had a known, large deficit in working capital, resulted from further deterioration in its financial condition. These 1962 "worries" of Hopkins were solely as to Trice's performance as operator of the properties and not as to any inadequacy of the reserves, which was not even suspected by Hopkins. Some delays in monthly remittances by Trice had occurred and there were reports that a few of the wells were not producing to the extent expected, due to lack of purchaser demands and pipe line connections, and temporary operating problems.

and omissions were not obvious . . . Nor did Hopkins have 'ready access to the information' which LaPiere misrepresented or omitted to furnish" (App. B. 13).

And with respect to proof of actual reliance, the District Court said:

"Hopkins contends that *Mills* (and *Rosenstiel*) have dispensed with the requirement of reliance, *per se*, in 10(b) and similar cases, where materiality and causation are present. This Court, in this case, does not need herein to accept or repudiate that contention since, in 'this case, inquiry into the fact of' reliance is not impractical and such inquiry undisputedly establishes LaPiere's misrepresentations and omissions, their materiality, *and Hopkins' reliance upon them* . . . .

"Hopkins' reliance in this case thus *exceeds* the degree of 'some' — the standard set forth by Judge Winter in *Baumel v. Rosen, supra* at 140 in the course of setting forth his 'reading' and 'employment' of Section 10(b) and Rule 10b-5, a 'reading' and an 'employment' which were specifically approved by Judge Bryan, speaking for himself and Judges Sobeloff and Boreman. 412 F.2d, *supra* at 574. In this case, materiality and causation, *and reliance in and of itself*, are independently established by the undisputed facts insofar as the two 10(b) counts are concerned" (App. B. 17 to 19).

Affirming, the Court of Appeals had this to say:

"We think the undisputed facts support the district court's summary finding of liability upon counts, II, III and V. . . . . Reliance, of course, is not an operative element under the Section 12(2) count and we were not called upon to make a specific evaluation on that point in our former opinion. While the case of *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), has cast some doubt upon the part played by reliance in Rule 10b-5 cases, *we do not find it necessary* to concern ourselves with the dialogue of whether some degree of reliance is still a factor in face-to-face transac-

tion involving misrepresentations and nondisclosure such as we presently have before us. On the prior appeal we stated that '[i]nformation about future revenues was essential *to Hopkins' decision* to purchase, and this information was tainted by LaPiere's material misrepresentations and omissions,' and assuming that in a case such as this some degree of reliance is necessary, we think the essentiality of the tainted information satisfies the accepted criteria of reliance which were delineated in *List v. Fashion Park, Inc.*, 340 F.2d 457 (2 Cir. 1965). *See Baumel v. Rosen*, 283 F. Supp. 128, 140 (D.C. Md. 1968), *reversed on other grounds* 412 F.2d 571 (4 Cir. 1969)" (App. A. 4).

The Facts

Huttons' incomplete and misleading statement of The Facts calls for many corrections. Some of the more important facts relating to Huttons' fraud and Hopkins' reliance should be stated. They are omitted from Huttons' Statement but were considered by the District Court and the Court of Appeals, each of which has on two occasions found liability to be established by undisputed facts, and each of which in considering Counts II, III and V, has found without a dissent, the fact of Hopkins' reliance to be similarly established.

Early in August, 1960, LaPiere, since 1957 Manager of Huttons' Oil and Gas Department, began negotiations with Bankers Trust Company, in which he induced that bank to place with its nominee, and finance the purchase for $1,375,000, an oil and gas production payment of Trice to be retired out of production from 18 oil and gas wells in Louisiana, Texas and Oklahoma. Thus, as defendant William E. Hutton subsequently wrote Bankers Trust in an effort to persuade that company to purchase a third Trice production payment, Hutton had become, by the sale of oil production payments, "engaged in a refinancing program for Trice Produc-

tion Company through Gilbert LaPiere, the Manager of our Oil Department".[3]

Although the activity of Hutton in 1960 and 1961, primarily through LaPiere, in selling and attempting to sell production payments of Trice was extensive, it was not Huttons' only financial activity with Trice. During the period 1956-1962, four Hutton partners and their relatives invested over $1,200,000 in Trice drilling programs and Hutton handled for their customers similar investments totaling more than $2,400,000, the heaviest investments being made in 1961. For "screening" these programs alone Hutton earned more than $144,000 (A. 135-137).

On September 14, 1960, LaPiere and Trice called on Ragnar Naess of Naess & Thomas, investment advisers of New York who numbered Hopkins among their long-time clients. They outlined orally to Naess, telling him that a brochure or prospectus would be supplied shortly, an oil and gas production payment and an attached net profits interest, which Hutton was offering for Trice and which would be payable out of production from the 18 wells to be subject to the Bankers Trust production payment and from five additional wells.[4] This was one of a series of sales of production payments designed to relieve Trice's severe shortage of working capital. Hutton (Petition p. 8) say that Trice then offered Naess a "2% finder's fee," but fail to state that Naess turned down the offer and accepted no fee or

---

[3] Hutton to Pelley, 2/27/61 (E. 193). (E,A and SARR references herein are to pages of the printed Appendix filed with the Court of Appeals in No. 72-1995. At the suggestion of the Clerk's Office we have not requested that this Appendix be certified to this Court.)

[4] A production payment is payable out of the production from reserves of oil and gas wells purchased outright, and is not the financial obligation of the seller (Trice), as Hutton tries to insinuate (Petition, p. 12) (App. F. 165, 166).

commission whatever. At their request Naess arranged for them to meet with Baker, Hopkins' Treasurer, in Baltimore on September 21, 1960 (A. 916, 920-923, 1138).

At that meeting LaPiere and Trice reviewed with Baker, and left with him, a brochure dated September 16, 1960, presenting for sale for $1,300,000, though not in well-by-well detail, the production payment previously discussed with Naess[5] (E. 82). The figures in this brochure, which LaPiere represented to be the estimates of independent petroleum engineers, showed an estimate of future net revenue from the wells of $6,560,000 and stated that the share of Hopkins, as the purchaser of the production payment, would be $2,905,000. This meeting on September 21, 1960, was the only meeting which Hopkins had with Trice or any of its employees, before Hopkins' Finance Committee voted to make the investment on January 27, 1961.

This brochure, the figures it contained, including the estimates of yearly realizations, and what LaPiere represented them to be, were completely false to the knowledge of LaPiere. The reserve estimates as earlier represented by LaPiere to Bankers Trust were more than $1,200,000 less than the $6,560,000 represented to Hopkins (App. F. 20, 22). LaPiere not only affirmatively misrepresented them but he concealed from Hopkins the true estimates and other schedules which he then had in his possession.

Hutton was at this time, and continued to be, highly regarded and trusted by Hopkins. Two of its partners were

[5] This was the same document which LaPiere in his letter of 2/3/61 to Baker (E. 162) represented as "my brochure". It was also the same document to which Baker referred in his note made three weeks later, when he first discussed the proposal with the Finance Committee of Hopkins, viz: "Resumé by W. E. Hutton salient" (E. 119; A. 297-298).

resident in Baltimore and Iglehart,[6] an employee of Hutton, was the son-in-law of Charles S. Garland, Chairman of Hopkins' Trustees and member of its Finance Committee (A. 872, 880-881, 899).

Following his meeting with LaPiere and Trice, Baker suggested to Naess that, although the proposal had "passed substantial professional scrutiny", it might be well for Hopkins, since neither Hopkins nor Naess had any familiarity with oil production payments and engineering estimates, to have its own adviser to check the independent engineering reports (E. 116, 88). LaPiere recommended to Naess the hiring of Chester Brown, then an employee of Chase Manhattan Bank but scheduled, through the good offices of LaPiere whom he had known well for a long time, to join with one Gordon Meeks, whom Naess had met, to form Petroleum Consultants, Inc. Naess then recommended Brown to Baker in October and LaPiere offered to come to Baltimore for a meeting of the Finance Committee later that month to explain further the proposal. However, the Finance Committee determined to postpone consideration until a later time (E. 86, 115, 116; A. 641, 980, 986, 1028, 1064-1065, 1083-1088).

On December 7, 1960, LaPiere and Trice again called on Naess. At their request Naess again telephoned Baker, this time to determine whether Baker felt that Hopkins' Finance Committee might now be prepared to give consideration to the proposed production payment. It was agreed that Baker would determine the disposition of the Finance Committee

[6] Iglehart's diary (E. 89) records that on September 22, 1960, he discussed with LaPiere the latter's meeting of September 21 with Baker; that on four occasions during October and November he contacted or attempted to contact Garland with respect to Hopkins' possible interest in the production payment, and that on January 27, 1961 Garland "called to say Hopkins has bought idea of oil payment subject to final papers."

at its meeting on December 23. If the answer were affirmative, LaPiere would attend the Committee meeting on January 27, 1961 (A. 619-621, 936).

At its meeting on December 23, 1960, the Committee determined that it would like to discuss the investment on January 27, 1961, when Naess would be present (for his regular quarterly discussion of the market outlook), and that it would "like to have a representative of W. E. Hutton & Company present." Baker was requested to circulate data on the proposal to members of the Committee prior to the January 27 meeting. Trice's offer to pay the cost of the University's technical representative was noted. This offer was of course made after LaPiere's friend Brown had been agreed upon to perform this function[7] (E. 139).

Baker turned to LaPiere for the data to be circulated to the Finance Committee and, in response to the request, LaPiere wrote his letters of January 4, 1961 and January 16, 1961, in which he represented that the production payment was offered in an amount "which the properties can support" and that such amount "is determined by independent engineers that have estimated the reserves and income" and that "the income projection" is "substantiated by reservoir engineers' studies". The latter letter, along with the September 16 brochure containing the false figures, were the only things Baker circulated to the Committee prior to the meeting of January 27, 1961 (E. 140, 143, 145, 149; A. 751).

Leaving nothing to chance, LaPiere himself by letter of January 5, 1961, contacted his friend Brown directly and requested him, *on behalf of Hutton and Trice*, "to make a study and estimate the future net oil and gas reserves and

[7] Actually Hutton shared this expense equally with Trice (E. 198).

cash projection on certain properties of Trice Production Company." Brown was not told, however, that he was to act for Hopkins in doing so nor that Hopkins expected that he would check the reports of the independent engineers. LaPiere's oral instructions to Brown were to do a quick superficial study without too much detail. To make certain that there would be no direct contact between Hopkins and Brown, LaPiere directed Brown to send his report to him, LaPiere (E. 141, 191, 196; A. 158-162, 172-173, 1036-1037, 1049, 1061-1062, 1066-1072, 1083-1088, 1759). When LaPiere told Hopkins that Brown was already at work and represented to Hopkins, both in his letter of January 16, and orally at the Finance Committee meeting on January 27, that Brown was checking the earlier engineering estimates, Hopkins had no doubt that these representations were true. Hopkins did not learn the real truth about LaPiere's instructions to Brown, the fact that he worked for Hutton and Trice and not for Hopkins, and the limited job which he did, until March 18, 1963 (E. 145, 151a, 375; Baker Aff., Doc. 372, p. 6).

LaPiere attended Hopkins' Finance Committee meeting on January 27, 1961. Baker reviewed the proposal as outlined in LaPiere's September 16, 1960 brochure, using those figures and explaining that they were based on independent engineers' estimates of production. LaPiere confirmed Baker's explanation, stated that the original estimates "are now being checked by Chester Brown" whom he identified, as Hopkins believed, as having been selected by "Mr. Ragnar Naess to make this check for the University" and then reported orally the figures developed by Brown, which LaPiere stated "indicates that the Degolyer & MacNaughton estimates were conservative". At the conclusion of the meeting the Committee "approved the investment of $1,300,000 in

the oil and gas production payments as discussed and authorized the Treasurer to make the investment if details can be satisfactorily arranged" (E. 151). Following that meeting and as a step in arranging the legal details, Baker for the first time consulted Venable, Baetjer and Howard, who were Hopkins' counsel, through Cooper, one of the partners. Prior to that time Hopkins' counsel had not been consulted nor did they ever advise in any way Hopkins' decision to purchase (A. 1234-1235, 1260-1263).

By letter of February 2, 1961, LaPiere informed Trice that, at the Finance Committee meeting he had attended on January 27, Hopkins had agreed to purchase the production payment; that Baker or his attorney "will contact you in the next few days to work out the follow-through procedure" and that he had been instructed by Baker to see that any question which Trice might have should be referred to LaPiere at Hutton (E. 159).

Hutton in this case took and filed the deposition of Baker, Garland, Hopkins' Chairman, Nelson, Chairman of its Finance Committee, and W. Luke Hopkins, a member of the Finance Committee. They all testified without contradiction to Hopkins reliance on Hutton and on the misrepresentations of LaPiere (E. 119, 149, 177; A. 533-534, 568, 625, 641, 650, 676, 681, 868-869, 872-874, 877-878, 883-884, 888, 892, 896, 898-899).

On January 30, 1961, LaPiere called Baker to suggest that Hopkins confer with Trice's counsel, Worth McCauley, as to the form of the security, and two days later called again to say that McCauley would come to Baltimore to talk with Hopkins' counsel. Cooper suggested that McCauley come on February 7 and at the same time suggested that Baker should get from LaPiere a copy of each of the engineering

reports.* It was when Baker asked LaPiere for the engineering reports that LaPiere told him that Mitchell, Trice's chief engineer, would come to Baltimore with McCauley. When Mitchell came he did not bring the reports, Hopkins never saw them, but he did bring a false brochure of February 3, 1961, which supported in well-by-well detail, falsely attributing each estimate to a specific engineer, the false figures, totaling $6,560,000 of future net revenue, previously represented by LaPiere (E. 154, 158, 163; A. 589, 591-592, 596).

It was this brochure dated February 3, 1961, which attributed some of the false estimates for particular wells to the engineers of Mercantile National Bank. To that extent only it changed Huttons' initial representation that the independent engineers responsible for the $6,560,000 reserve estimate were Degolyer & MacNaughton and Schafer Engineering. LaPiere on the telephone corroborated this change to Baker, and Baker accepted it as a correction. This new brochure, however, did not *supersede* LaPiere's brochure dated September 16, 1960 as Hutton asserts (Petition p. 10). On the contrary, it *confirmed* exactly the false statement that the independent engineers' estimates totalled $6,560,000.

With his letter of February 3, 1961, LaPiere forwarded to Baker a summary of Brown's report (which, because of his instructions from LaPiere and the withholding from him of material information by Trice, was completely inaccurate) and commented on it at some length stating that it "is gratifying to know that the figures presented to you in my brochure of September 16, 1960 are conservative and now that Mr. Brown's figures are finalized, I believe that with

---

*Cooper has testified on deposition that, if he had known that Brown was checking these reports for Hopkins, he would not have made the suggestion. He felt no one at Hopkins was qualified to interpret such reports and retention of a specialist for that purpose would have been necessary (A. 1272-73).

the meeting on the 7th with Mr. McCauley and Mitchell, you will be able to proceed towards a favorable consummation of this $1,300,000 oil payment." LaPiere told Baker that he would "get in touch with you after your meeting on the 7th to see if there is anything I can do at that time." Following that meeting on February 7th, Baker sent to LaPiere excerpts from the minutes of four meetings of the Finance Committee "Having to do with our proposed investment through you" and asked that LaPiere let him know if he disagreed in any way with Hopkins' understanding as set out therein. LaPiere, by telephone, stated on February 14, 1961, that the minutes were "all correct" (E. 162, 177).

At the meeting on January 27, 1961 of Hopkins' Finance Committee, LaPiere suggested that, although the proceeds of oil and gas from Hopkins' production payment would be ample to take care of 6% interest on the investment, Trice would, if necessary, provide a guarantee of such interest. In late February 1961, in connection with the drafting of the security, this offer was accepted and this guarantee provided (E. 186). It was relatively unimportant as LaPiere indicated and as Baker testified (A. 786). In the first place, it guaranteed interest only, and only for a short period in which it was expected that Bankers Trust's production payment would be paid out. More importantly, it was given by Trice, who was known to Hopkins to have a deficit of $2,632,000 in working capital, and total liabilities over $4,000,000 in excess of total assets on an alleged cost basis. These Trice figures were supplied Hopkins by LaPiere on February 24, 1961, in a letter which argued their unimportance, because, he said, Hopkins "looks to the reserves for their guarantee", and not to impecunious Trice (E. 189, 187; A. 1500-1503).

LaPiere's intense activity in this transaction all through February 1961 negates Huttons' claim (Petition p. 12) that

by February 7, 1961, Hopkins had decided to "go it alone". In a letter to Trice dated June 15, 1961, explaining the delay in his efforts to sell another production payment to Guardian Life Insurance Company, LaPiere said that "as in the case of Johns Hopkins University it is a long tedious matter of educating them on the principles of an oil payment purchase . . .". (E. 222).

On March 1, 1961, Hopkins' purchase was consummated. As admitted by Hutton, Hopkins on that date, by its payment of $1,300,000 in exchange for a security then worth far less, sustained an enormous loss (SAAR 41, 44). In spite of Huttons' insinuations to the contrary (Petition p. 12), none of this loss is attributable to Trice's reorganization in bankruptcy, which occurred in October 1962. Those proceedings merely provided the opportunity for Hopkins' to learn some facts which in turn created its suspicion, later confirmed, that it had been defrauded.

ARGUMENT

In their Reasons for Granting the Writ, and supporting Argument, Hutton advance only two propositions. In the *first*, they claim that the decision that Hopkins is entitled to recover under Sections 10(b) of the Exchange Act and 17(a) of the Securities Act, notwithstanding Hopkins (not suspecting fraud and accepting the truth of Huttons' misrepresentations) did not make an affirmative investigation before it made the purchase and thereby discover Huttons' fraudulent material misstatements and omissions, is in "direct conflict" with certain statements concerning plaintiffs' diligence made in the course of deciding three recent cases by the Eighth, Fifth and Second Circuits. In their second proposition, Hutton claim that the Court of Appeals in the present case misconstrued, and then followed and misapplied, two recent decisions of this Court dispensing with

the need for the plaintiffs in those cases to prove factually that they actually relied on the defendants' material omissions.

Both of Huttons' propositions are unsound. The error in the *first* springs from Huttons' misunderstanding of the pronouncements, and the peculiar problem *of statutory coverage* to which they were directed, of two of the Circuits with which Hutton compare Hopkins' trusting behavior; and from Huttons' persistent distortion of the undisputed facts concerning Hopkins' reasonable conduct prior to the purchase. See our seven corrections in Huttons' Questions Presented Nos. 1 and 4 *supra*.

The error in the *second* of Huttons' contentions results from their patent misinterpretation of the Court of Appeals' affirmance in the present case of the factual finding of Hopkins' actual (not merely presumed) reliance on Huttons' misstatements and omissions, and its express assertions that it therefore had no need to rest its affirmance upon any dispensations indicated in the *Mills* and *Ute* decisions of this Court. See our criticism of Huttons' Questions Presented Nos. 2 and 3 *supra*.

I.

THERE IS NO CONFLICT BETWEEN THE PRESENT DECISION AND THE DECISIONS OR *DICTA* OF THE EIGHTH, FIFTH AND SECOND CIRCUITS.

The three cases as to which Hutton claims "direct conflict" are *City National Bank v. Vanderboom*, 422 F.2d 221, 230 ftn. 10 (8th Cir. 1970); *Clement A. Evans Co., Inc. v. McAlpine*, 434 F.2d 100, 104 (5th Cir. 1970); and *Kohner v. Wechsler*, 477 F.2d 666, 667 (2d Cir. 1973). They, and their particular "diligence" observations for which Hutton cite them, are all far afield from *Hopkins v. Hutton*. In *Vanderboom* and *Wechsler* there were no material misrepresenta-

tions or nondisclosures. In *Vanderboom* and *McAlpine* the defendants neither sold nor purchased the securities. They were not in privity with the plaintiffs and were not parties to the transaction in securities in question. And the problems in those cases, *with which the language cited by Hutton was concerned*, was as to the coverage of Section 10(b), *i.e.*, in what circumstances its provisions, because of the "in connection with the purchase or sale of any security" clause, should apply to alleged misrepresentations of third parties. There is no such statutory coverage question in the face-to-face direct sale in *Hopkins v. Hutton*. The District Court in the case at bar considered these cases and properly distinguished them (App. B. 13). It held that Hopkins, unlike the plaintiffs in *Vanderboom*, did not have "ready access to the information" which Hutton misrepresented and omitted to furnish, and that Huttons' misrepresentations and omissions, unlike those of the defendants in *McAlpine*, "were not obvious to 'even the most credulous mind'." There was nothing said or done, the District Court determined, which would have led Hopkins, as a reasonable man, to suspect that material information was being misrepresented or withheld (App. B. 13).

In *Vanderboom*, the Section 10(b) cause of action was asserted in a counterclaim, defendants alleging that plaintiff bank had misled their corporation. Defendants were stockholders of corporation X and they borrowed money on their individual notes from plaintiff bank to assist X in purchasing from Y the stock of AHB Corporation. After a four-month option period during which defendants had access to all the books and records of AHB and the auditors' report thereon, X made the purchase at too high a figure and thereby suffered a loss. In their counterclaim these individual defendants asserted that plaintiff bank knew of their purpose in borrowing the money and had misled them by failing

to pass on to them some information it had concerning the financial condition of AHB and the true value of its stock.

The District Court dismissed defendants' counterclaim, holding, (1) that the plaintiff bank had made no misrepresentations or misleading omissions; (2) that defendants, by giving renewal notes and making partial payments after they had knowledge of the grounds of their claim, were estopped by ratification to assert any misleading omissions by the bank, if there were any; and (3) that, because the bank did not offer or sell the AHB securities, but simply made the loans, its failure to disclose information to its borrowers concerning AHB was not within the statutory coverage of the "in connection with" clause of Section 10(b).

The Eighth Circuit affirmed the last ruling. But it first held that defendants had no standing to sue in their own right rather than derivatively for their corporation X, since X, and not the defendants personally, had purchased the AHB stock. The Eighth Circuit, in affirming the District Court, adopted the test fashioned by the Second Circuit,[9] but only for the coverage scope of Section 10(b) in cases where the alleged defrauding party does not make a purchase or sale of a security to the plaintiff. This objective forseeability test to determine whether a legal duty to disclose rests on the third person is whether a "reasonable investor" would have been "entitled" to rely on such third person's failure to disclose.

The defendants, counterclaiming in *Vanderboom*, had had, to the knowledge of the bank, access to all the books and records of the company acquired by X, and the auditors' report thereon, during a four-month period prior to X's purchase. Thus, the plaintiff bank could well believe that de-

[9] *Heit v. Weitzen*, 402 F.2d 909, 913 (2d Cir. 1968) and *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860 (2d Cir. 1968).

fendants had just as much, or more, knowledge of AHB's condition as the bank had. Therefore the bank, which, as the Eighth Circuit held, was in the position of "third parties who were not sellers and did not profit from the sale but who might have had some peripheral or general knowledge about the financial condition of AHB," did not owe a duty of full disclosure to the borrowing defendants. There is absolutely nothing in the case at bar which could have relieved Hutton, direct sellers earning a commission, from the duty to Hopkins to disclose the true facts.

McAlpine was a case in which the plaintiff (here again suing a person not party to the sale for alleged misrepresentations) had actual *knowledge* of the true facts claimed to be misrepresented. The plaintiff brokerage firm permitted one McAlpine to deal in securities with it on credit, thereby ultimately sustaining a loss of $308,000, represented by five checks which McAlpine gave it which were dishonored when presented and never paid. Plaintiff claimed that a defendant brokerage firm and its registered representative were liable to it for these losses, because the defendant brokerage firm, also dealing with McAlpine and assisting him in other "kiting" transactions, had thereby falsely "created a facade of financial responsibility for McAlpine." It appeared, however, that the plaintiff, in its transactions with McAlpine over a three to four month period prior to its losses on McAlpine's five bad checks, had received a number of other dishonored checks from McAlpine, — an "explosive" situation according to one of plaintiff's employees. Plaintiff, therefore, had knowledge while it continued to extend credit to McAlpine that the "facade of financial responsibility" allegedly created for him by the defendants was false.

On such facts (and the Court held they were "not in dispute") it would appear at once that the plaintiff brokerage

firm was not misled by representations implied in defendants' conduct. The trial court, instead of taking this simple course, instructed the jury to the effect that any information received by plaintiff "of sufficient substance *to arouse suspicion*" would warrant them finding "that the plaintiff had knowledge of facts sufficient to excite its inquiry", and that they could find "that the *peculiar circumstances* of this case were sufficient to impose on plaintiff a duty of due diligence". The jury found for the defendants, and the Fifth Circuit, interested primarily in the extent of the statutory coverage of Section 10(b), and quoting from the opinion in *Vanderboom* relevant on that question, affirmed. Obviously the instruction complained of in *McAlpine* was more favorable to the plaintiff than the facts warranted, so it could not complain. The Fifth Circuit, in its discussion, indicated that belief in the misrepresentation of defendant as to McAlpine's financial responsibility in the setting of what plaintiff actually knew about him might "tax even the most credulous mind".

In *Wechsler*, plaintiff Kohner sought to rescind his purchase from Wechsler, for $650,000, of all the outstanding shares of a small corporation under the federal securities statutes, including Section 10(b). He alleged that Wechsler had falsely represented to him that the corporation had not engaged in price discrimination violative of the Robinson-Patman Act or other illegal activities. Several months after his purchase Kohner claimed to have discovered that the company had given jobbers selling its products different discounts, and that it had unpaid certain customs duties on certain of its importations of molds from Canada. The District Court after trial dismissed the complaint. It found, *first*, that any omission by Wechsler with regard to the customs duties was immaterial, because the possible injury to Kohner therefrom was "de minimus," the unpaid duties

amounting to less than $2,000. It also found that the only material representation sued on was true, that the company had not violated the Robinson-Patman Act because the varying discounts it gave jobbers were to meet competition in good faith. In its opinion, completely as an aside and *obiter*, the District Court also stated:

> "In addition, the court notes that the plaintiff, an experienced businessman and a sophisticated investor had many financial advisors to assist him in carefully analyzing defendant Wechsler's business before the sale was finalized. In this situation, there is no duty to disclose information to one who reasonably should already be aware of it."

Each member of the three-judge panel of the Second Circuit wrote a separate opinion. Each one expressly affirmed the decision of the District Court that there had been no material misrepresentation. In only one of the opinions was there any allusion to the *dictum* of the trial court which is set forth on page 15 of Huttons' Petition.

Huttons' argument, based on its misreading of these three cases, that unsuspecting Hopkins was required to doubt and not to believe Huttons' statements and was required to investigate affirmatively Huttons' material sales representations is merely an attempt to assert, without support, a supposed defense of contributory negligence to a wrong inflicted *with scienter;* and to revive the discredited doctrine of *caveat emptor*, notwithstanding the completely contrary purpose of the securities legislation. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); *Cf. Dale v. Rosenfeld*, 229 F.2d 855 (2d Cir. 1956). No such duty was imposed upon a trusting victim of unobvious fraud by the better view even at the common law. See *Federal Trade Commission v. Standard Education Society*, 302 U.S. 112, 116 (1937); *Bishop v. E. A. Strout Realty Agency*, 182 F.2d

503, 505, 506 (4th Cir. 1950); A.L.I. *Restatement of Torts*, Sec. 538(1) and (3) and Comment on Subsection (3); Sec. 540, and Sec. 541 and Comment.

II.

HOPKINS WOULD HAVE BEEN ENTITLED TO RECOVER UNDER THE *MILLS* AND *UTE* DECISIONS EVEN IF IT HAD NOT PROVED ACTUAL RELIANCE ON THE "DEFECTS" (MATERIAL MISSTATEMENTS AND OMISSIONS) IN HUTTONS' SALE SOLICITATIONS.

Hutton is completely in error in contending (page 16 of their Petition) that the Court of Appeals, in holding on the second appeal that Hopkins relied upon Huttons' material misstatements and omissions (i.e., the "defects" in Huttons' sale solicitations, as distinguished from the sale solicitations containing them) did no more than repeat its *causation* determination on the first appeal. They are equally in error in contending (on the same page of the Petition) that the Court of Appeals held them "liable under Section 10(b) on the same proof, *of materiality only*, previously cited by the Court on the first appeal".

In approving, in its second opinion, the District Court's augmented and specific findings of Hopkins' actual reliance, however, the Court could not help recognizing, as a first step toward such approval of the finding of reliance, that it had previously determined that Hopkins had relied on Huttons' sale solicitations. It had already found the "essential[ity]" (i.e., the indispensable importance) of Huttons' information concerning the future revenue estimates "to Hopkins' decision to purchase". But this determination of the indispensability to Hopkins subjectively of the tainted information had been earlier made solely in the course of the Court's prior finding of *proximate causation* (App. E. 8, 9). The Court had already (in an earlier and separate portion of its first opinion) concluded, *for different reasons and on different proof*, that objective materiality was undisputed, "resting

as it does upon the reaction of a 'reasonable' man" (App. E. 7).

On the first appeal involving only Section 12(2), which requires causation but not reliance, the Court had held that it was not necessary for Hopkins to prove, and for the Court to find, "that the defects in LaPiere's data had a decisive effect on its contract" (App. E. 9). This additional feature, however, — the last step in Hopkins' reliance *on Huttons' fraud* — was supplied by the District Court's express and specific findings on remand when it proceeded to adjudicate the Sections 10(b) and 17(a) claims. And the Court of Appeals in its second opinion affirmed those additional conclusions.

This is particularly clear from the fact that, in that affirmance, the Court of Appeals held for the first time that "the accepted criteria of reliance which were delineated in *List v. Fashion Park, Inc.*, 340 F.2d 457 (2 Cir. 1965)" were satisfied (App. A. 4). The Court also here cited *Baumel v. Rosen*, 283 F. Supp. 128 (D. Md. 1968) at p. 140, where actual reliance was required to be found, and was found, in a Section 10(b) case and was affirmed in 412 F.2d 571 (4 Cir. 1969). The "criteria of reliance" in *List* were the importance of the misrepresentations, the "defects", *subjectively to the particular plaintiff*. These criteria contained something more than importance to the "reasonable" investor objectively, which is *materiality*. They also contained something more than the importance of the sale solicitations, as distinguished from the "defects" therein, which is *causation*. It must be noted that the lower Courts found that the criteria of actual reliance in *List* were exceeded in the present case. "Essentiality" of the misstatements and omissions is something more than "a substantial factor" and "importance", the criteria of *List*. The District Court also concluded that Hopkins' reliance "exceeds the degree" of

reliance that was required by the Fourth Circuit in *Baumel v. Rosen* (App. B. 18 to 19).

The uncontradicted evidence more than supported the presence of these reliance criteria. Indeed, Huttons' counsel in his affidavit filed in opposition to Hopkins' Motion For Summary Judgment — the principal affidavit in opposition and the only affidavit remotely dealing with this subject — claimed that Hopkins was *too trusting* of Huttons' representations, and clearly conceded not only materiality but Hopkins' actual subjective reliance on Huttons' concealments.

This affidavit (A. 252) forthrightly and unqualifiedly admitted with emphasis:

> "Had Hopkins made such examination [of the independent engineers' estimates] there *undoubtedly* would have been no purchase and no litigation".

This admission that Hopkins would have acted differently had it known the estimates concealed by Hutton is the legal test in *List* of reliance on an omission.

The proof indisputably establishes that Hutton, by their long, ardous and persistent sale solicitations, "induced Hopkins to buy", as the District Court expressly found (App. F. 111, B. 18). It indisputedly established that Hutton "offered and ultimately sold to Hopkins" the security, as the Court of Appeals expressly found on the first appeal (App. E. 6). It follows beyond question that Hopkins placed reliance on Hutton and on Huttons' sale solicitations, and that their offerings were "an essential link in the accomplishment of the transaction."

And Hutton had and used no other selling means than their misrepresentations of the reserve estimates. It follows that, if Hopkins relied on Hutton and their sale solicitations, it necessarily relied on the only important feature of those

solicitations, the misstatements and omissions. The evidence therefore conclusively showed that not only Hutton and their solicitations were "an essential link in the accomplishment of the transaction", but the falsity of those solicitations was.

But, if the above were not so, Hopkins still contends that the undisputed materiality and causation would entitle it to recover under the decisions of this Court in *Mills* and *Ute*.

The similarities of this case to the situations in *Mills* and *Ute* far outweigh the minor dissimilarities. In all three cases the defrauders proximately caused the injury. In all three cases there were misleading omissions. In the present case there were affirmative misstatements by Hutton as well. In all three cases the misleading omissions were material. Indeed, in the present case, Huttons' omissions were far more gross than those of Electric Auto Lite in *Mills*, or those of Gale and Haslem in *Ute*. In our case, the Court of Appeals in its first opinion said:

> "But here the discrepancies in basic date are so large, and the facts misrepresented *and withheld* are so obviously important to an investor that reasonable minds cannot differ on the question of materiality" (App. E. 7).

In *Ute* and in *Hopkins v. Hutton* the negotiations were direct and face to face. In *Hopkins v. Hutton* they were far more so, Hutton being the persistent selling brokers, whereas Gale and Haslem in *Ute* were much less directly involved. In all three cases the victims could have discovered the fraud, but in each case it would have taken first suspicion and then an affirmative investigation to have done so.

What are the dissimilarities? Hutton stresses the large number of victims in *Mills*, and on page 17 of their Petition offer a *partial* quote from footnote 5 at page 382 of this Court's opinion that "proof of actual reliance by thousands of individuals . . . would not be feasible . . .". But the con-

cluding part of the sentence from which that partial quotation is taken gives an additional reason. The rest of the sentence reads: "and reliance on the *nondisclosure* of a fact is a particularly difficult matter to define or prove, see 3 L. Loss, Securities Regulation 1766 (2d ed. 1961)". This additional reason given by this Court for dispensing with reliance where materiality and causation exist, is applicable to all Section 10(b) cases, even cases of individual plaintiffs.

Hutton (Petition p. 18) emphasized that the defendants in *Ute* "were engaged in a palpable scheme to defraud". They can hardly advance this fact as a distinction between *Ute* and the present case. For in both cases the scheme was not "palpable" in the sense of being obvious to the one defrauded; and in both cases the respective schemes to defraud have by litigation become "palpable". Huttons' scheme to defraud, now established by uncontradicted evidence to the satisfaction of three separate judicial tribunals, was far the more gross and reprehensible. For the only real dissimilarity between *Ute* and the case at bar, Hutton would contrast the lack of sophistication of the Ute Indians with the general knowledgeability of Hopkins in usual matters of finance. Unquestionably this difference existed, although, as we have pointed out Hutton has greatly magnified it, since Hopkins had no sophistication whatever in the type of oil security Hutton offered and were expert in.

We cannot believe that these mere differences — more victims in *Mills* and less sophisticated victims in *Ute* — require a difference in result as far as requiring proof of actual reliance is concerned. The main purpose of requiring reliance at all is to insure that causation exists. See *List v. Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir. 1965); *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1172 (2d Cir. 1971). That problem is not presented in any of the three cases.

Nor do we believe that reaching a different result as to the reliance requirement because of these particular differing features in the cases noted above is desirable for the achievement of the fundamental purposes of the federal securities statutes or for their effective enforcement. We have authoritative teaching that those purposes were "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus achieve a high standard of business ethics in the securities industry"; and that Congress intended this legislation to be construed "not technically and restrictively but to effectuate its remedial purposes". *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186, 195 (1963); *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *Affiliated Ute Citizens v. U. S.*, 406 U.S. 128, 151 (1972). In the light of these principles it has become basic that the federal securities statutes did not simply enact, expressly or by implication, the whole panoply of common law deceit, but far more favorable standards for the "protection of investors".

In *J. I. Case v. Borak*, 377 U.S. 426 (1964), at p. 432, this Court likened the private civil enforcement of the securities statutes to the effective weapon in the supplementary enforcement of the federal antitrust laws provided by the private treble damage actions. If such private enforcement of the salutary provisions of the securities statutes is to be encouraged, it should not be largely frustrated by imposing the often difficult task of demonstrating reliance upon material omissions, in cases where causation is clearly established.

Requiring no proof of a supposed legal element by untutored Indians in *Ute* or by "a musical director and commentator" in *Chasins v. Smith Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970), but requiring proof thereof by "businessmen" to a degree which grows progressively greater depending on

the degree of general education possessed by the particular businessmen, may have some appeal to paternalistic sympathy, but it lacks any support in the legislation. The legislation is concerned with eradicating *fraud of the wrongdoers* and improving *their ethical standards*. Such difference in plaintiffs' legal rights would certainly not tend to encourage private supplementary enforcement of the statutes.

Hutton contended in the District Court that Hopkins was too sophisticated an investor to receive any protection from these statutes. Judge Kaufman disposed of that contention at some length in his opinion of August 15, 1968, noting: "the cases are replete with instances in which sophisticated investors have been permitted to recover" (App. F. 100, 101).

CONCLUSION

Hopkins respectfully submits that Huttons' Petition for Certiorari should be denied.

Respectfully submitted,

JOHN HENRY LEWIN,

EDMUND P. DANDRIDGE, JR.,

Attorneys for Respondent.

February 28, 1974.

CERTIFICATE OF SERVICE

I hereby certify that on February 28, 1974, I served upon Petitioners three copies of the foregoing BRIEF OF RESPONDENT, THE JOHNS HOPKINS UNIVERSITY (HOPKINS), IN OPPOSITION by depositing said copies in a United States post office, with first class postage prepaid, addressed to Petitioners' attorneys of record at their post office address:

John A. Wilson, Esquire and
Michael J. DeSantis, Esquire
53 Wall Street
New York, New York 10005.

I further certify that all parties to be served have been served.

EDMUND P. DANDRIDGE, JR.
1800 Mercantile Bank and Trust
Building — Two Hopkins Plaza
Baltimore, Maryland 21201

Counsel for Respondent